

BEFORE THE STATE **BOARD** OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of }  
CITC INDUSTRIES, INC. AND }  
BOB WOLF ASSOCIATES, INC. }

For Appellants: Mark D. Pastor  
Attorney at Law

For Respondent: Bruce **W.** Walker  
Chief Counsel

Kendall E. Hinyon  
Counsel

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of CITC Industries, Inc. **and Bob** Wolf Associates, Inc. against proposed assessments of **addi-**  
**tional** corporate income tax as follows:

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	<u>Income Years Ended</u>	<u>Proposed Assessments</u>
CITC Industries, Inc.	1/31/67	\$ 1,273.40
	1/31/68	601.58
	8/31/68	409.36
	12/31/68	557.27
Bob Wolf Associates, Inc.	12/31/69	\$10,555.19
	12/31/69	10,555.19
	12/31/70	25,802.51
	12/31/70	36,457.70

and pursuant to section 26076 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of CITC Industries, Inc. for refund of corporate income tax as follows:

	<u>Income Years Ended</u>	<u>Claim for Refund</u>
CITC Industries, Inc.	1/31/65	\$ 6,908.68
	1/31/66	14,756.75
	8/15/66	16,450.43
	1/31/67	7,911.80
	1/31/68	16,073.58
	9/9/68	11,392.96
	12/31/68	10,679.57
	12/31/69	24,485.63
	12/31/70	21,870.35

At the request of respondent, appellant CITC Industries, Inc. (hereinafter CITC) filed corporation franchise tax returns for its income years 1965 through 1969. The return for the income year ended January 31, 1965, reflected a self-assessed commencing corporation liability of **\$2,514.43**. It is respondent's position that, in view of the limited nature of CITC's California activities, the returns were erroneously filed under Chapter 2 of the Bank and Corporation Tax Law (franchise tax) instead of Chapter 3 (corporation income tax). In accordance with section 25401 of the Revenue and Taxation Code, the returns should now be considered as filed under the proper chapter, Chapter 3. Respondent has conceded that appellant has overpaid its corporation income tax liability for taxable year 1965 in the amount of the self-assessed commencing corporation liability of **\$2,514.43**, and that upon resolution of this appeal the overpayment with interest as provided by law shall be credited to any tax due from appellant and the balance refunded.

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During the course of this appeal, pursuant to stipulation by the **parties**, the joint appeals for the years subsequent to 1968 were dismissed as follows:

	<u>Income Years Ended</u>	<u>Proposed Assessments</u>
Bob Wolf Associates, Inc.	12/31/69	\$10,555.19
	12/31/69	10,555.19
	12/31/70	25,802.51
	12/31/70	36,457.70
	<u>Income Years Ended</u>	<u>Claim for Refund</u>
CITC Industries, Inc.	12/31/69	\$24,485.63
	12/31/70	21,870.35

The remaining issue on appeal relates solely to CITC.

CITC is a New York corporation with its main office in New York City. The directors' and officers of **CITC** maintain **their offices in New York City where all directors' and** shareholders' meetings are held. **Most** of its 80 employees are located in New York and include executive, sales, **financial**, accounting, administrative and clerical personnel. All business policy and management decisions are made in New York.

CITC is the United States sales representative for the Mitsubishi Footwear **Division** of Mitsubishi International Corporation (hereinafter Mitsubishi), a Japanese manufacturer and exporter of tennis shoes, **getas** and zories. CITC salesmen solicit orders throughout the United States for Mitsubishi. Purchase orders so solicited are transmitted to **CITC's** New York office for review and tentative approval or rejection. Upon tentative approval, the purchase orders are processed and forwarded to Mitsubishi in Japan for final approval or rejection. If the order is accepted, Mitsubishi ships the footwear to the United States on an **FAS** (free alongside ship) basis which requires the customers to bear all docking and other costs in transporting the merchandise to their individual places of business. CITC does not maintain any merchandise inventory in California and is not, in any **way**, involved in the transportation of the merchandise. The manufacturer retains legal title to all goods prior to delivery to customers. At no time does CITC have legal title or any other **property inter-**est in the footwear. Mitsubishi is solely **responsible** for determining credit availability and terms, billings, collections, accounting and servicing of customers. In return for **the efforts**

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of its employees in soliciting purchase orders, **CITC** receives a ten percent commission. All commission income earned by CITC is paid to it in New York.

In February 1964 CITC rented and furnished a sales office in Los Angeles. The office was used by the two to four salesmen who solicited purchase orders from customers in California and surrounding states. A receptionist was also present at the office to answer the telephone, take messages for the solicitors and to receive and send their mail. The sales office was listed in the classified section of the **LOS** Angeles telephone directory under "**Shoes-Wholesale.**" Salesmen were listed in the white pages of the telephone directory under their own names, along with the company's office address and telephone number. The office was also listed in the white pages of the telephone directory under the name "**Mitsubishi Footwear.**"

CITC does not maintain any accounting or financial facilities in California. All bills are paid from New York where all the financial and accounting records are maintained. CITC maintains no bank or savings account in California. Federal payroll tax returns are filed in New York.

Based on these facts, respondent determined that California had jurisdiction to tax **CITC** and demanded that it file returns. Although contending that it was immune from California income tax by Public Law No. 86-272 (73 Stat. 555 (1959), X5 U.S.C. § 381), CITC ultimately filed delinquent returns in 1971 and paid the amounts shown to be owing. Upon receipt of the delinquent returns, respondent imposed a 25 percent late filing penalty for all years. **CITC** protested the late filing penalty and filed claims for refund. Thereafter, respondent audited appellant's books and records. The audit disclosed that errors had been made in determining the amount of income apportionable to California and notices of additional proposed assessments were issued. Appellant protested the additional assessments contending that it was immune from California tax under Public Law No. 86-272.

In response to appellant's protest, respondent withdrew the penalties, affirmed the additional proposed deficiencies but took no action on appellant's claims for refund. Appellant filed a timely appeal from respondent's action affirming the notices of proposed assessment. Thereafter, in view of respondent's failure to act upon the claims within six months from the date of filing, appellant deemed the claims disallowed pursuant to section 26076 of 'the Revenue and Taxation Code and filed a timely appeal. Both appeals have been consolidated.

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The sole issue for determination is whether appellant is immune from the California corporate income tax Within the purview of **Public Law** No. 86-272.

Section 23501 of the Revenue and Taxation Code provides that every corporation deriving income from sources within this state shall be subject to a tax on such income. The United States Supreme Court has held that a state may constitutionally tax a **corporation's** net income from operations exclusively in interstate **commerce**, provided the tax is not discriminatory, is properly apportioned to local activities and there is a sufficient connection **or nexus** between the taxpayer and the state to support the tax. (Northwestern States Portland Cement Co. v. Minnesota and Williams v. Stockham Valves and Fittings, Inc., 358 U.S. 450 [3 L.Ed.2d 4211 (1959)]; 'see also West Publishing Co. v. McColgan, 27 Cal; 2d 705 [166 P.2d 861] **affd.** per **curiam** 328 U.S. 823 [90 L.Ed. 1603] (1946).)

To assuage the fears of the business community that the Northwestern-Stockham decision would be extended to allow states to tax the net income of foreign corporations whose only contact with the taxing state was the mere solicitation of orders. **Public Law** No. 86-272 was enacted in 1959. (See generally, Lohr-Schmidt, Developing Jurisdictional Standards for State Taxation of Multistate Corporate Net Income, 22 **Hast. L.J.** 1035 (1971); Note, State Taxation of Interstate Commerce; Public Law 86-272, 46 **Va. L. Rev.** 7 (1960).) **Public Law** No. 86-272, the effect of which is to prohibit a state from imposing a net income tax on income derived from interstate commerce when the only business activity conducted within the state consists of soliciting orders for the purchase of tangible personal property, provides in pertinent part:

(a) **No** State. . . shall have power to impose,  
. . . a net income tax on the income derived  
within such State by any person from inter-  
state commerce if the only business activities  
within such State by or on behalf of **such**  
person during such taxable year are. . .

(1) the solicitation of orders by such  
**person, or** his representative, in such  
State for sales of tangible personal  
property, which orders are sent outside  
the State for approval or **rejection**, and;  
if approved, are filled by shipment or  
delivery from a Point outside the State:  
and

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(2) the solicitation of orders by such person, or his **representative**, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Appellant contends that the business activity conducted in California by **CITC** is restricted to the solicitation in interstate commerce of purchase orders which must be forwarded out-of-state for approval or rejection; and concludes that the corporation was immune from taxation by California pursuant to Public Law No. 86-272. Appellant's argument ignores the import of its own Statement of Fact No. 9 **at pages 4 and 5** of their brief filed with this board which states:

9. CITC rents some space in a building in the County of Los Angeles. This space **is** used at times by the solicitors who normally have done the solicitation in California for CITC. A receptionist is generally present at these premises and she answers the **telephone** and takes messages for the solicitors, and receives and sends their mail. The solicitors normally do their contact work in California at the place of business of the purchasers, or potential purchasers or at public restaurants or other places of public **accommodation**.

The maintenance and operation of a **sales office** within the state does not come within the minimum standards of immunity from state taxation contained in Public Law No. 86-272. Senate Bill 2524, which became Public Law No. 86-272, originally contained a subparagraph (3) in section **101(a)** which would have granted immunity when a business or its representative maintained and operated an office in the taxing state for the primary purpose of serving representatives engaged in soliciting orders. (See generally, **S. Rep. No. 658, 86th Cong. 1st Sess. (1959) U.S. Code Cong. & Ad. News 2554.**) Specifically, subparagraph (3) of section **101(a)** of the bill as introduced in the Senate protected:

the maintaining and operation by such **person**, or by his representative, in such state of an office the primary purpose and use of which is to serve representatives of such person who are engaged in the solicitation of orders

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described in paragraphs (1) or (2), or both,  
and to receive, process, and forward such  
orders.

Subparagraph (3) was deleted from the bill by the Senate when it adopted the amendment of Senator Talmadge of Georgia. In introducing his amendment, Senator Talmadge stated:

I am seeking to strike subparagraph (3),  
on page 2, which would deny to 50 states in  
the Union the right to tax nonresident corpora-  
tions which are maintaining offices and doing  
business within the States. (105 Cong. Rec.  
16471 (1959).)

Thus, there is no question that the maintenance of a sales office by the seller is not within the exemption accorded by Public Law No. 86-272. (See Appeal of Nardis of Dallas, Inc., Cal. St. Bd. of Equal., April 22, 1975; Lohr-Schmidt, Developing Jurisdictional Standards for State Taxation of Multistate Corporate Net Income, supra, 22 Hast. L.J. at 1065; Note, State Taxation of Interstate Commerce; Public Law 86-272, supra, 46 Va. L. Rev. 300-313, 315.)

In line with Congressional intent as expressed by the enactment of Public Law No. 86-272 with the Talmadge amendment, the courts and this board have strictly limited the statutory immunity from state taxation to solicitation or activities incidental thereto. (See, e.g., Olympia Brewing Co. v. Oregon Department of Revenue, 266 Ore. 309 [511 P.2d 837] (1973), cert. den., 415 U.S. 976 [39 L.Ed.2d 872] (1974); Herff Jones Co. v. State Tax Commission, 247 Ore. 404 [430 P.2d 998] (1967); Appeal of Nardis of Dallas, Inc., supra; Appeal of Riblet Tramway Company, Cal. St. Bd. of Equal., Dec. 12, 1967.) Since appellant's California activities exceeded solicitation or activities incidental thereto, the immunity from state taxation afforded by Public Law No. 86-272 is unavailable to it. Accordingly, respondent's action in imposing a corporate income tax upon appellant must be sustained.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED,  
pursuant to section 25667 of the Revenue and Taxation Code,  
that the action of the Franchise Tax Board on the protest  
of CITC Industries, Inc. against proposed assessments of addi-  
tional corporate income tax as follows:

<u>Income Years</u> <u>Ended</u>	<u>Proposed</u> <u>Assessments</u>
1/31/67	\$1,273.40
1/31/68	601.58
8/31/68	409.36
12/31/68	557.27

be and the. same is hereby sustained; and pursuant to section  
26077 of the Revenue and Taxation Code, that the action of the  
Franchise Tax Board in denying the claims of CITC Industries,  
Inc. for refund of corporate income tax as follows:

<u>Income Years</u> <u>Ended</u>	<u>Claim for</u> <u>Refund</u>
1/31/65	\$ 6,908.68
1/31/66	14,756.75
8/15/66	16,450.43
1/31/67	7,911.80
1/31/68	161073.58
9/9/68	11,392.96
12/31/68	10,679.57

be and the same is hereby modified in accordance with respon-  
dent's concession and in all other respects the action of the  
Franchise Tax Board is sustained.

Done at Sacramento, California, this 28th day of  
June , 1979, by the State Board of Equalization.

William L. Barnes, Chairman  
Robert J. [Signature], Member  
Robert [Signature], Member  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member